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HESS

Jay L. Kooper
Director of Regulatory Affairs
Energy Marketing

June 3, 2011

VIA ELECTRONIC FILING AND OVERNIGHT MAIL
Hon. Rosemary Chiavetta
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

RE: Docket No. I-2011-2237952 – Investigation of Pennsylvania's Retail Electricity Market – Comments of Hess Corporation

Dear Secretary Chiavetta:

Pursuant to the Commission's Order entered on April 29, 2011 in the above-referenced proceeding, Hess Corporation ("Hess") submits an original and five (5) copies of its written comments enclosed herein and submits an electronic copy filed through the Commission's e-file system as well as an e-mail courtesy copy to the Office of Competitive Market Oversight.

Kindly date stamp and return in the enclosed self-addressed stamped envelope the extra paper copy enclosed herein. If you have any questions, please do not hesitate to contact me at (732) 750-7048. Thank you for your attention to this matter,

Sincerely,

Jay Kooper

Jay L. Kooper
Director of Regulatory Affairs

Enclosure

cc: Office of Competitive Market Oversight (via e-mail at ra-OCMO@state.pa.us)

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COMMONWEALTH OF PENNSYLVANIA
PUBLIC UTILITY COMMISSION

Investigation of Pennsylvania's Retail Electricity Market	))	Docket No. I-2011-2237952

COMMENTS OF HESS CORPORATION

INTRODUCTION

Hess Corporation ("Hess") submits these comments in response to the Commission's Order issued on April 29, 2011 in the above-referenced proceeding.[1] Through this Order, the Commission begins a comprehensive process to engage stakeholders "with the goal of making recommendations for improvements to ensure that a properly functioning and workable competitive retail electricity market exists in [Pennsylvania]."[2]

Pennsylvania has served as both a national leader in electricity policy and a benchmark for the progress of competitive electricity markets since the passage of the Electricity Generation Customer Choice and Competition Act ("Competition Act")[3] in 1996. In recent years, the Commission has done a remarkable job transitioning Pennsylvania from a structure based on long-term generation rate caps to a retail electric

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[1] *See Investigation of Pennsylvania's Retail Electricity Market*, Docket No. I-2011-2237952, Order (entered April 29, 2011) ("Order").

[2] *See Order* at 2, n.4, *citing Joint Application of West Penn Power Company d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company and FirstEnergy Corp. for a Certificate of Public Convenience under Section 1102(a)(3) of the Public Utility Code approving a change of control of West Penn Power Company and Trans-Allegheny Interstate Line Company*, Docket Nos. A-2010-2176520 and A-2010-2176732, Opinion and Order (entered March 8, 2011) ("FirstEnergy-Allegheny Merger Order"), at 46.

[3] 66 Pa. C.S. §§ 2801-2812 (Act 129 of 2008 subsequently amended Chapter 28 of the Public Utility Code and added Sections 2813-2815).

market structure that at this early stage has indisputably provided both choice and value to a large segment of Pennsylvania customers.

Going forward, as the Commission explores policy options to improve Pennsylvania's retail electric market it is critical to preserve best practices where retail competition has taken firm root – particularly the medium-sized and large commercial and industrial ("C&I") customer segments. It is equally critical that where improvement is needed, the resulting market structure both preserves the fundamental tenets of retail competition – proactive shopping and affirmative choice for customers – and protects customers and the competitive market from the threat of anticompetitive and discriminatory conduct that can erode the progress of Pennsylvania's transition to competition.

With these principles in mind and as discussed in more detail below, Hess recommends that the Commission, as part of this proceeding, enact retail market improvement policies that: (1) preserve as a "best practice" the strong and robust structure now in place for medium-sized and large C&I customers – specifically, hourly-priced default service; (2) explore expansion of the hourly-priced default service to additional smaller commercial customer segments prepared for such a transition; (3) prevent involuntary auctioning or assignment of C&I customers to a default service provider or competitive electric generation supplier ("EGS") they did not affirmatively choose; and (4) establish default service structures that adequately mitigate the risk of anticompetitive and discriminatory conduct in Pennsylvania's retail electric market caused by the high amount concentration that exists in the Commonwealth's default service markets.

COMMENTS

I. THE COMMISSION SHOULD PRESERVE HOURLY-PRICED DEFAULT SERVICE FOR MEDIUM-SIZED AND LARGE C&I CUSTOMERS AND EXPLORE ITS EXPANSION TO SMALLER COMMERCIAL CUSTOMERS

A. The Present Status of Retail Electric Competition For Medium-Sized and Large C&I Customers Under Hourly-Priced Default Service is Strong Under All Critical Metrics.

The most important component for a default service structure that enables robust retail choice is the provision of real and accurate market price signals to customers who are able to use this data to shop for their choice of EGS product that best fits their consumption needs. In Pennsylvania, this concept has either already been applied or is in the process of being applied to medium-sized and large C&I customer groups within all of the major Pennsylvania electric distribution company ("EDC") service territories.

Currently, customers with a peak load share of 300 kilowatts ("kW") and higher in the Duquesne service territory and 500 kW and higher in the PPL service territory are on hourly-priced default service. On January 1, 2012, customers with a peak load share of 400 kW in the Met-Ed and Penelec service territories and 500 kW in the PECO and Allegheny service territories will likewise complete their post-rate-cap era transition to hourly-priced default service. Even at this very early stage of competition in Pennsylvania, it is clear that under three critical metrics, retail electric competition for these medium-sized and large C&I customers groups subject to or in the process of transitioning to hourly-priced default service is an overwhelming and undisputed success.

First, the level of switching for customers subject to hourly-priced default service is remarkably high. According to the Commission's "PA Power Switch" website, as of May 25, 2011, 83.1% of the total statewide electric load for industrial customers –

customers on or transitioning to hourly-priced default service – has switched to competitive EGS service.[4] With respect to Pennsylvania's major EDC service territories nearly all of the industrial load has switched to competitive EGS service, including 96.6% of the industrial customer load in Penn Power, 95.7% in PPL, 92.1% in Duquesne, 91% in PECO, 85.4% in Penelec, and 83% in Met-Ed.[5]

Second, a substantial number of competitive EGSs are actively marketing and offering competitive products to business customers within Pennsylvania's major EDC service territories. According to the Commission's, "PA Power Switch" website, there are 46 EGSs actively marketing to business customers in the PECO and PPL service territories, 29 in Duquesne, 26 in Met-Ed and Penelec, 24 in Allegheny Power and 18 in Penn Power.[6]

Third, and perhaps most significantly, the breadth and depth of innovative and value-added competitive products offered by EGSs for C&I customers has increased dramatically since the lifting of the rate caps. For example, Hess, a Fortune 100 company[7] and licensed EGS serving medium-sized and large C&I customers,[8] markets and offers in Pennsylvania a variety of traditional electric pricing options, including a fixed-price product (Hess Fixed Price), variable/market-based products (Hess Time-of-

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[4] *See* Pennsylvania PUC "PA Power Switch" webpage <http://extranet.papowerswitch.com/stats /PAPowerSwitch-Stats.pdf?/download/PAPowerSwitch-Stats.pdf>.

[5] *Id.*

[6] *See* Pennsylvania PUC "PA Power Switch" webpage at <http://www.papowerswitch.com/shop-for-electricity/shop-for-your-business/>.

[7] *See* Fortune Magazine, Fortune 500 – 2011 List at <http://money.cnn.com/magazines/fortune/fortune500 /2011/snapshots/204.html> (ranking Hess at number 74 on the 2011 Fortune 500 list).

[8] *See Amendment to Electric Generation Supplier License of Hess Corporation*, Docket No. A-11005, Order (entered April 15, 2011), at 2 (detailing Hess's history as a licensed EGS in Pennsylvania).

Use and Hess Indexed Price) and hybrid fixed and variable price products (Hess Fixed and Index Combination).[9]

In addition, in recent years Hess, in response to C&I customer demand and through a default service structure that has conveyed market-reflective price signaling to this customer group, introduced innovative, value-added green products. This includes Hess Demand Response (where Hess facilitates and manages a C&I customer's participation in PJM's demand response program), Hess Renewable Energy (enabling customers to purchase Green-e certified renewable energy credits from Hess), and Hess C-Neutral (enabling customers to purchase carbon offset credits for anywhere from 1 to 100% of their carbon footprint).[10] In total, Hess offers approximately seven different electricity pricing and value-added green products throughout the major Pennsylvania EDC territories.

Placing together the three metrics of: (1) customer switching; (2) number of EGSs; and (3) breadth and depth of EGS product offerings, Hess offers seven different electricity pricing and value-added green products competing with anywhere from 18 to 46 other EGSs in the major Pennsylvania EDC territories, many who likewise offer multiple innovative products and services to remain competitive against Hess. For C&I customers subject to or transitioning to hourly-priced default service, this has resulted in over 83% of this group's statewide load switching to competitive EGS supply. This is clear evidence of a robust competitive retail electric market structure and confirmation that the present status of retail electric competition for this customer segment is strong.

[9] A summary of Hess's electric product offerings can be found on the Hess Energy Marketing website at <https://www.hessenergy.com/products/electricity/Index.aspx>.

[10] A summary of Hess's value-added green product offerings can be found on the Hess Energy Marketing website at <https://www.hessenergy.com/products/Green/Index.aspx>.

B. Default Service That Is Divorced From Market-Reflective Prices Presents Barriers To Fully Workable and Competitive Retail Markets, Even When They Are Based on Short-Term Prices.

The role of default service in a competitive retail market is to serve as a backstop and not a barrier to retail choice for customers. In order to achieve this balance, default service must be a simple, "plain vanilla" service in contrast to the differentiated, specialized and innovative product alternatives provided by EGSs. Where the default service is hourly-priced default service this balance is achieved and barriers to retail market entry are extremely low. Where the default service is at least in part based on fixed prices, barriers that prevent customers from obtaining and EGSs from offering the benefits of a fully workable and competitive retail market are significantly higher. This is true even for customer segments where the default service is based on relatively shorter-term one-year or two-year fixed prices.

Default service based on a portfolio of fixed prices creates barriers in three critical ways. First, it transforms the role of default service from that of a last-resort "plain vanilla" backstop to that of a differentiated and specialized first-resort product that directly competes with EGS products. Second, it places EDCs and EGSs on an inherently uneven competitive playing field because EDCs have a procurement cost advantage in providing the fixed-price default service whereby they can recover such costs from ratepayers while EGSs bear all risks associated with their procurement on behalf of their customers. Third, it separates sophisticated customers – namely C&I customers below the hourly-priced default service threshold cut-off – from their ability to receive and respond to market-reflective price signaling that is critical to their ability to shop for and choose a compatible product.

Hess recognizes that there are longstanding policy concerns in protecting the smallest customers (i.e., residential and small commercial customers) from a highly volatile default service structure. Hess also acknowledges that there periodically can be and, in Pennsylvania, has been robust competition in markets that have had default service based on a blend of very short-term fixed-price procurements. However, any time default service is divorced from market-reflective pricing, there is high risk that barriers to retail competition will emerge. The Commission's switching numbers for commercial customers below the hourly-price default service threshold confirm the existence of these barriers, with smaller commercial load switching percentages well below those of industrial customers.[11]

Hess respectfully observes that if Pennsylvania is to move forward in removing these barriers to retail competition – barriers that impact commercial customers with peak load shares as high as 499 kW within major EDC territories – then the Commission should utilize this proceeding to expand a "best practice" in the form of hourly-priced default service that has provided robust choice to medium-sized and large C&I customers.

C. The Commission Should Use This Docket To Explore Expansion of Hourly-Priced Default Service To Smaller Commercial Customers With a Peak Load Share of 100 kW and Higher.

Given the success of hourly-priced default service as an effective tool for fostering a fully workable and competitive retail electric market for medium-sized and large C&I customers, the Commission should use this docket to explore expansion of this structure to smaller commercial customers through a careful and orderly transition. It is Hess's experience that the vast majority of customers with a peak load share of 100 kW

[11] *See* Pennsylvania PUC "PA Power Switch" webpage, n. 4, *supra*.

and higher are sophisticated enough to warrant consideration of their inclusion in the hourly pricing model for default service. These business customers are already sophisticated buyers of goods and services, both inside and outside of the electric shopping context, and have the ability to understand the several electricity product options available to them and the impact of these options on their bottom line. In addition, with this customer segment already subject and acclimated to a default service based on a mixture of spot market and short-term fixed prices, movement to an hourly-priced default service presents a logical next step in a transition that will expose them to more accurate price signaling and more innovative options.

Accordingly, the Commission, as part of this proceeding, should examine the feasibility of incorporating hourly-priced default service as a tool to generate more robust competition for commercial customers with a peak load share of 100 kW and higher. Borrowing on a proven successful formula, this examination should assess "best practices" from the recent transition of medium-sized and large C&I customers to hourly-priced default service. Such a transition for smaller commercial customers should include a start date of June 1, 2013 for this new default service to correspond with the expiration of the existing EDC default service plans. In addition, this transition should include a comprehensive customer education campaign and highly focused operational coordination between EDCs and EGSs in the period leading up to and immediately following the start date of the new default service.

II. THE COMMISSION SHOULD NOT ADOPT ANY DEFAULT SERVICE STRUCTURE THAT INVOLUNTARILY AUCTIONS OR ASSIGNS C&I CUSTOMERS TO A DEFAULT SERVICE PROVIDER OR EGS THEY DID NOT AFFIRMATIVELY CHOOSE.

The hallmark of a fully robust and workable competitive electric market is customer choice; the ability of customers to proactively shop for and affirmatively choose a pricing or other value-added product that best fits their electric usage needs from an EGS with whom the customers wish to do business. This is especially true for C&I customers given both their level of sophistication as businesses themselves with eyes on their bottom lines and with energy costs being among their most significant cost drivers. For many C&I customers in Pennsylvania, hourly-priced default service is an effective tool for ensuring a robust competitive market that fosters and enables affirmative customer choice.

By contrast, in recent years some stakeholders have proposed more aggressive alternative default service structures. One such example is the proposed alternative default service structure involving a combination of the EDC exit from the default service role and an auction or assignment of retail customers by the new default service provider to EGSs. A variant of this structure was most recently proposed by Direct Energy for mass market customers as part of this Commission's review of the FirstEnergy-Allegheny merger.[12] Within the context of this proceeding investigating Pennsylvania's retail market, it bears mentioning that from Hess's perspective such a structure is both

[12] *See* FirstEnergy-Allegheny Merger Order, at 42-47.

inappropriate for non-mass market C&I customers[13] and fundamentally inconsistent with the core premise of retail competition – customer choice.

First, a core component of this alternative structure is the involuntary auction or assignment of a customer to an EGS the customer did not affirmatively choose. This is antithetical to the fundamental purpose of retail competition – giving customers the ability to proactively shop for and affirmatively choose the EGS product or service that best fits their needs. This is especially true for C&I customers sophisticated enough to start and operate a business in Pennsylvania. As part of the necessity of controlling operating costs and keeping their eyes on their bottom lines, these C&I customers should never be placed in a situation where they are involuntarily auctioned or assigned to an EGS who they have not engaged or bargained with.

Second, with respect to this alternative structure's other component – the exit of the EDC from the default service role – there has yet to be a proposal that has provided clear enough definition to ensure that such a structure would not create the same or additional barriers to retail market entry than EDC-provided default service. For example, a structure that requires alternative default suppliers to serve all customer classes discriminates against EGSs who are serving or plan to serve just one customer segment in Pennsylvania and minimizes the pool of eligible EGSs for the default service role. In addition, with the default service role in all practicality having been a monopoly role up to now, it is unclear what remedies would be available to EGSs experiencing operational barriers with an alternative default service provider. Currently, the Commission has strong jurisdiction and oversight over the EDC as the default service provider as EDCs

[13] For purposes of these comments, Hess defines "non-mass market C&I customers" as C&I customers with a peak load share below 100 kW. Hess makes no recommendations at this time for default service for residential and small C&I customers below this threshold.

are comprehensively regulated by the Commission. It is unclear whether this same level of regulation and oversight can be provided where a competitive EGS is providing the default service – and where that EGS in addition to providing the default service is actively competing against other EGSs with competitive product offerings of its own. Such uncertainty creates risk of preservation and even expansion of barriers to retail market entry.

Third, as discussed above hourly-priced EDC-provided default service is a proven effective tool for fostering robust competition within the C&I customer segment and is one that both promotes and respects the concept of affirmative customer choice. In reviewing options for fostering more retail competition in Pennsylvania, the Commission should give greater weight to proposed structures that empower and enable proactive customer shopping and affirmative customer choice. Involuntary auctioning or assignment of C&I customers, however labeled, is at its base involuntary and not consistent with customer choice. From Hess's perspective, this is a tool that should not be utilized by the Commission in fostering an improved retail electric market for non-mass market C&I customers in Pennsylvania.

III. THE COMMISSION SHOULD ADOPT DEFAULT SERVICE STRUCTURES THAT CAN ADEQUATELY MITIGATE THE RISK OF ANTICOMPETITIVE AND DISCRIMINATORY CONDUCT IN PENNSYLVANIA'S RETAIL ELECTRIC MARKET

One significant challenge facing the Commission with respect to improving Pennsylvania's retail electric market is that the Commonwealth's default service markets are highly concentrated. In the absence of effective tools to mitigate the risk of anticompetitive or discriminatory conduct – risk that is always prevalent in highly concentrated markets – the development of a workably competitive retail electric market is, at best, likely to be frustrated or, at worst, stopped altogether. In a recent dissenting opinion, Commissioner (then Chairman) Cawley provided a vivid example of this consequence with his concern that a default service provider's access to its merged parent's substantial generating fleet would place the provider's EGS affiliate in a position to dominate Pennsylvania's retail electric market and simultaneously stifle competition from competing EGSs.[14] As the Commission shifts to a process to improve Pennsylvania's retail electric market, it is essential that tools designed to eliminate even the risk of the scenario eloquently painted by Commissioner Cawley are implemented and ensconced in future retail electric market design.

Hess believes that there are two mitigation tools worthy of the Commission's consideration at this early stage of this proceeding. The first tool is the expansion of hourly-priced default service because of its plain vanilla lack of differentiation. By establishing the default service as hourly and based on the PJM spot market, a default

[14] *See Joint Application of West Penn Power Company d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company and FirstEnergy Corp. for a Certificate of Public Convenience under Section 1102(a)(3) of the Public Utility Code approving a change of control of West Penn Power Company and Trans-Allegheny Interstate Line Company*, Docket Nos. A-2010-2176520 and A-2010-2176732, Dissenting Statement of Chairman James H. Cawley (dated Feb. 24, 2011).

service provider cannot compete with the highly differentiated and innovative product offerings of the EGSs through default service, which is the proper role of default service in a retail market structure. In addition, any procurement cost advantage a default service provider may have is minimized because the default service price is spot-market based. Furthermore, if the default service can only be an hourly-priced default service based on the PJM spot market, then the opportunity for a default service provider to generate a cost advantage through generation ownership is greatly reduced.

The second tool, for smaller customer groups where the Commission may be reluctant to implement hourly-priced default service, is a descending-clock auction procurement process similar to the New Jersey Board of Public Utilities' ("NJBPU") current procurement for that state's Basic Generation Service ("BGS").[15] Under this procurement structure, New Jersey's four EDCs procure their BGS (i.e., default service) supply through a multiple round, descending clock auction format that is supervised by the NJBPU and managed by a neutral third-party consultant.[16] For New Jersey BGS customers not subject to hourly-priced default service, one-third of their default service requirements for a three-year period are procured at each annual BGS auction.

The descending-clock auction mechanism is an effective mitigation tool in two important respects. First, it ensures that EDC procurement for default service is subject to a competitive bidding process by multiple default service suppliers under the monitoring of the NJBPU. Second, it places an effective cap on load for a single annual

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[15] *See* New Jersey Board of Public Utilities Docket No. ER10040287, *I/M/O the Provision of BGS Service for the Period Beginning June 1, 2011*, Decision and Order (Dec. 6, 2010) ("2010 BGS Order").

[16] *See* 2010 BGS Order, at 3 and New Jersey BGS Auction webpage at <http://www.bgs-auction.com/bgs.auction.overview.asp> for a detailed overview of the BGS auction format.

auction. For example, in New Jersey customers who are not subject to hourly-priced default service receive a BGS fixed price that is the product of a 33.33% load cap since only one-third of that customer groups' load is procured in a single auction process. These measures, separately and together, greatly lower the risk of anticompetitive conduct because they preclude the ability of a supplier to utilize a high concentration of generation assets to drive out competition in the retail market.

Accordingly, to the extent the Commission is reluctant to implement hourly-priced default service for smaller commercial customers as recommended by Hess, it should consider as an alternative establishing a descending-clock auction system for default service procurement that is compatible with Pennsylvania's retail electric market structure for these customers.[17]

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[17] In proposing consideration of the descending clock auction format as a market mitigation tool, Hess is aware that some smaller commercial customer default service structures in Pennsylvania produce more market-reflective prices than the 3-year rolling average price that is the product of New Jersey's BGS-Fixed Price auction (i.e., the auction for New Jersey customers not subject to hourly-priced default service). To preserve this "best practice" component of Pennsylvania's retail market structure for smaller commercial customers, Hess recommends that any implementation of a descending-clock auction format in Pennsylvania should be carefully structured so as to not make existing small commercial customer default service structures based on a mix of spot market, 1-year and 2-year prices, less market reflective.

CONCLUSION

Hess appreciates the opportunity to submit these comments and looks forward to further participation in this proceeding. For the reasons set forth above, Hess recommends that the Commission preserve and expand best practices such as hourly-priced default service for medium-sized and large C&I customers. In addition, Hess recommends that the Commission avoid implementing involuntary migration structures for non-mass market C&I customers that fundamentally contradict affirmative customer choice. Finally, Hess recommends that the Commission implement effective mitigation tools such as hourly-priced default service or descending clock auction mechanism to prevent the risk of anticompetitive and discriminatory conduct stemming from high concentration in Pennsylvania's default service markets.

Dated: June 3, 2011
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Respectfully submitted,

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